

Q-38: Assume that an option granted and exercised during January of 1982 automatically qualifies, by its terms, for ISO treatment. During February of 1982, the same employee exercised a second option, one that had been granted during 1978. Prior to the exercise of the 1978 option, it was amended under the transitional rules (see A-3) so that it would conform to the section 422A qualification requirements (see A-2(c)). If the 1978 option is properly elected to receive ISO treatment (see A-4), will such an election adversely affect the 1982 option's status as an ISO?

A-38: Yes. The election of the 1978 option to receive ISO treatment will automatically disqualify the 1982 option. If the 1982 option is to qualify as an ISO, it cannot be exercised prior to the exercise or expiration of all ISO's previously granted and outstanding on the 1982 option's date of grant (see A-2(c)(7)). When the 1982 option was granted during January of 1982, the 1978 option was already granted and outstanding for purposes of the section 422A sequential exercise restriction.

RECEIPT OF PROPERTY OR CASH UPON
EXERCISE OF AN ISO

Q-39: Section 422A provides that ISO treatment will be available even though the employee has the right to receive cash or other property at the time of the exercise of the option, so long as such property is subject to inclusion in income under section 83 (see A-2(d)(3)). To what extent does section 422A permit the use of tandem options and stock appreciation rights (SARs) in connection with ISO's?

A-39: A tandem stock option, wherein two options are issued together and the exercise of one affects the right to exercise the other, is not permitted because such a tandem option arrangement may be used to evade the section 422A qualification requirements (see A-2(c)).

A tandem ISO-SAR, wherein an ISO and an SAR are granted together and the exercise of one affects the right to exercise the other, is permitted so long as the SAR, by its terms, meets the following requirements:

(a) The SAR will expire no later than the expiration of the underlying ISO.

(b) The SAR may be for no more than 100% of the spread, *i.e.*, the difference between the exercise price of the underlying option and the market price of the stock subject to the underlying option at the time the SAR is exercised.

(c) The SAR is transferable only when the underlying ISO is transferable, and under the same conditions.

(d) The SAR may be exercised only when the underlying ISO is eligible to be exercised.

(e) The SAR may be exercised only when there is a positive spread, *i.e.*, when the market price of the stock subject to the option exceeds the exercise price of the option.

If all of the above requirements are met, for purposes of the 422A sequential exercise restriction (see A-2(c)(7)), a tandem ISO-SAR will be considered exercised in full when either the underlying ISO or the SAR is exercised. Additionally, SAR's may be paid in either cash or property, or a combination thereof, so long as the section 83 income inclusion rule applies to any property so transferred.

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**PART 15—TEMPORARY INCOME
TAX REGULATIONS RELATING TO
EXPLORATION EXPENDITURES IN
THE CASE OF MINING**

Sec.

15.0-1 Scope of regulations in this part.

15.1-1 Elections to deduct.

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15.1-4 Special rules.

AUTHORITY: Sec. 7805, 68A Stat. 917; 26 U.S.C. 7805.

SOURCE: T.D. 6907, 31 FR 16776, Dec. 31, 1966, unless otherwise noted.

§ 15.0-1 Scope of regulations in this part.

The regulations in this part relate to expenditures of the type described in section 615(a) or in section 617(a)(1) paid or incurred after September 12, 1966. The regulations in this part do not apply to the income tax treatment of mining exploration expenditures paid or incurred before September 13, 1966, and no election made pursuant to the provisions of the regulations in this part shall have any effect on the income tax treatment of exploration expenditures paid or incurred before such date. See § 15.1-4 for rules relating to treatment of exploration expenditures paid or incurred during taxable years beginning before September 13, 1966, and ending after September 12, 1966.

§ 15.1-1 Elections to deduct.

(a) *Manner of making election—(1) Election to deduct under section 617(a).* The election to deduct exploration expenditures as expenses under section 617(a) may be made by deducting such expenditures in the taxpayer's income tax return for the first taxable year